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POLICIES TO COMBAT DEPRESSION

INTRODUCTION

Herbert Stein, committee for economic development

The papers published in this volume were presented at two conferences held in Princeton, New Jersey—the first on October 30–31, 1953, and the second on May 14–15, 1954.

The purpose of the conferences was to survey the existing state of readiness to deal with the problem of depression, in terms both of understanding the problem and of the availability of instruments to deal with it. The conferences were not called in the expectation that the United States was about to encounter a major depression, although there was a feeling, in early 1953, that we were entering a period of increased vulnerability to an economic decline.

There were two main reasons why the conferences were called when they were. First, there had been a number of important developments in the economy in the preceding fifteen years or so which would affect its ability to resist a depression. The change in the size and character of the federal budget and the alterations in the banking structure are outstanding examples. While these developments were widely recognized, attempts to assess their significance had been fragmentary. It seemed timely to try to obtain a more systematic quantitative appraisal of their importance. Second, the depression problem had slipped far from the center of attention it formerly held in the work of economists. This was natural and, to some extent, a move in the direction of better balance. But there was a possibility that the appeal of more fashionable subjects was causing undue neglect of still-vital problems. It seemed desirable to see whether aspects of the depression problem would emerge which deserved more attention than they were getting.

Even in four days of conference it was not possible to cover all phases of antidepression policy. The selection of subjects reflects, in part, the planning committee's estimate of relative importance. But this was not the whole explanation of the selection. One area—the contribution of private business—was excluded because it had been thoroughly discussed in a recent Universities–National Bureau Conference on Regularization of Business Investment. In one or two cases the choice of subjects was influenced by the possibility of getting constructive papers written in the time available.

I shall not attempt here to summarize the papers or to deduce their net conclusion about our ability to deal with the depression problem. There are, however, a few observations that should be made to place the papers in perspective.

For the past twenty years or so the question of what causes business depressions has seemed not to be importantly involved in the question of how to prevent, check, or correct depressions. "Raise total money spending" was all we needed to know; the cause and specific location of the deficiency in spending did not matter. Now both Mr. Gordon's paper and Mr. Boulding's paper present the possibility that depressions differ in specific causes and in other respects in ways that call for different policies to deal with them. This view certainly has great appeal. Its acceptance, however, requires us to face two problems. First, we must learn what measures are appropriate to each of many possible kinds of depressions. Second, we must learn to identify the kind of depression we confront in time to select the appropriate policy. On the first point the Gordon and Boulding papers are highly suggestive, but their authors would probably not regard them as definitive. On the second point neither the papers nor the discussion are encouraging.

If we must be able to detect specific economic imbalances or deficiencies in order to deal with the depression problem satisfactorily, we probably have a long way to go. But this may imply too stringent a standard of what is satisfactory. We may be able to improve greatly on our past record in combating depressions without knowing a great many things that we should ideally know.

Mr. Roosa's paper on monetary policy deals with an aspect of the problem of detecting and responding to specific qualitative features of business declines. Is it sufficient to say that we will ease bank reserves when business is too low and tighten them when busines is too high? Or is the specific point in the capital markets where reserves are injected or withdrawn a matter of primary or at least important concern?

Somewhat similar questions about what we need to know are raised by Mr. Caplan's paper on the recession of 1948–1950. There were, and still are, apparently substantial differences of opinion about what was going on in the economy at that time. There were disagreements about whether we were going to have a recession, whether it would be deep or long, what might be responsible for it. We know from subsequent revisions that many of the statistical series studied at the time were seriously in error.

Nevertheless the policy followed seems to have been about right. How can this be explained, and, more important, can we count on a repetition of this fortunate outcome? Was it just luck? Did the policy reflect an equilibrium between budget balancers and tax cutters, between all-outers and stand-patters—and is that equilibrium likely to persist? Or is it sufficient for most practical purposes to be able to make certain gross distinctions about the economic situation —as between rampant inflation and reasonable stability or between moderate recession and deep depression?

The papers by Miss Merriam and by Messrs. Lusher, Cohn, Fox, Heer, Goode, and Pechman are important contributions to the evaluation of various aspects of the built-in flexibility of government finance. From this portion of the conference's work we can get good estimates of what may be called the first-round effects—the extent to which government receipts, expenditures, or deficits will be influenced by certain assumed changes in income or employment. This brings us to the borders of another problem, namely, How will the economy respond to the operation of the built-in stabilizers? The Lusher and Fox papers make some approach to answering this question, in addition to measuring the first-round effects.

To make progress in appraising the built-in stabilizers we must test them—on paper—in a variety of models of possible economic declines. The effectiveness of the stabilizers will depend upon the relative weight of autonomous initiating factors and of multiplying factors in the decline as well as upon other specific features of the situation. This is not a matter only of the extent to which the decline will be cushioned by built-in stabilizers. In some models of economic declines the built-in stabilizers will stop a decline and initiate an upturn.

The development of realistic models of cyclical responses is, of course, a difficult task and one that is receiving much attention. I wish to point out only that appraisal of the strength of built-in stabilizers depends upon fairly specific assumptions about the response pattern, even when the first-round effects are known.

At many points in this volume we are evaluating as antidepression instruments programs that have important objectives other than preventing depressions. This is conspicuously true of the papers on public works, housing, international commodity programs, and international monetary arrangements by Messrs. Owens, Grebler, Johnson, and Triffin. This volume can present only part of the evidence that is needed for policy judgments on these matters.

In a broader sense, a conference on antidepression policy deals with an abstraction. We want not merely to prevent depressions but to do so while doing certain things about economic efficiency, economic growth, price levels, economic freedom, and other objectives. The limitations that these other objectives might impose on anti-depression policy were not much discussed at the conferences, perhaps because there is so much implicit agreement to accept these limitations. But the question would undoubtedly have been more prominent if the conferences had tried to arrive at a Program for Action.

Our authors were given a relatively short time for preparing the papers contained herein. On behalf of the planning committee I wish to thank the authors and discussants for their cooperation throughout. I also wish to express our thanks to Messrs. Charles T. Broderick, Grover W. Ensley, and Irwin Friend, who participated in a panel discussion, not reproduced here, on signals for action to prevent depression. Also distributed to members of the conference were selected portions of two studies under way at the National Bureau of Economic Research—John Firestone's "Cyclical Behavior of Federal Receipts and Expenditures, 1879–1949" (mimeographed, NBER, 1955), and Daniel Creamer's *Personal Income during Business Cycles* (Princeton University Press for NBER, 1956).

The services of Mr. Daniel M. Holland of the National Bureau in organizing the meetings and guiding the production of this volume were invaluable. Members of the National Bureau's editorial staff performed the indispensable tasks of bringing order and finally print out of a welter of manuscript.

Mr. Donald H. Wallace served as chairman of the planning committee for the conferences until his death on September 19, 1953. In this project, as he had in many others, he displayed that competence and generosity that so endeared him to all his colleagues.

The other members of the planning committee were:

Lester Chandler
Gerhard Colm
Melvin G. de Chazeau
Daniel M. Holland
Geoffrey H. Moore
Lawrence H. Seltzer
Arthur Smithies

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